

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

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CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

CEA-01 DODE-00 PM-04 H-02 L-03 PA-01 PRS-01 FEAE-00

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R 071530Z JUL 76

FM AMEMBASSY LIMA

TO SECSTATE WASHDC 835

INFO AMEMBASSY BOGOTA

AMEMBASSY BRASILIA

AMEMBASSY CARACAS

AMEMBASSY LA PAZ

AMEMBASSY QUITO

AMEMBASSY SANTIAGO

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EO 11652/ NA

TAGS: EFIN, EGEN,EALR, PE

SUBJ: PRIME MINISTER AND MINISTER OF ECONOMY DEFEND
DEVALUATION AND OTHER NEW ECONOMIC MEASURES

REF: LIMA 6017

1. SUMMARY: IN A ONE-HOUR TELEVISED ADDRESS ON EVENING OF JUNE 30 PRIME MINISTER JORGE FERNANDEZ MALDONADO AND MINISTER OF ECONOMY AND FINANCE LUIS BARUA PRESENTED AND DEFENDED THE GOPI S NEW AUSTERITY PROGRAM. THE PRESENTATION DID NOT DISCUSS IN DETAIL THE NINE DECREE LAWS PUBLISHED ON JUNE 30 IN REGARD TO CONTENT OR IMPACT ON THE PERUVIAN ECONOMY. END SUMMARY.

2. THE PRIME MINISTER PRESENTED THE FOLLOWING ARGUMENTS:

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(A) THAT THE OVERCOMING OF DEPENDENCY AND UNDERDEVELOPMENT

REQUIRED PROFOUND STRUCTURAL TRANSFORMATION IMPLYING HIGH SOCIAL COSTS; (B) THAT PERU IS NOT AN ECONOMIC ISLAND BUT MOVES ESSENTIALLY WITHIN A MARKET CONTEXT INTERNATIONALLY; (C) THAT MAJOR STATE INVESTMENT PROJECTS WOULD BEGIN TO PRODUCE IN THE NEAR FUTURE WHICH WOULD COMPENSATE FOR THE SACRIFICES DEMANDED TODAY; (D) THAT THERE HAD BEEN AN EXPLOSIVE GROWTH IN THE PRICES OF PERU'S IMPORTS AND THAT THE GOP HAD ATTEMPTED A POLICY OF SUBSIDIES TO MITIGATE THE DOMESTIC EFFECTS OF THESE PRICE INCREASES; AND (E) THAT THE CRISIS HAD BEEN ACCENTUATED BY THE DECLINE IN THE ANCHOVY CATCH AND DECREASES IN WORLD PRICES OF PERU'S OTHER EXPORTS. GIVEN THESE FACTORS, HE STATED THAT THE GOP HAD TO TAKE SEVERE ECONOMIC MEASURES TO GENERATE THE FINANCIAL RESOURCES TO PURSUE REVOLUTIONARY DEVELOPMENT. HE STATED THAT THE CONTRADICTION APPARENTLY CREATED BETWEEN PERU'S PARTICIPATORY AND PLURALISTIC SOCIALISM AND THE SEEMINGLY CAPITALISTIC MEASURES BEING APPLIED BY THE GOP AT THE PRESENT TIME CAN BE UNDERSTOOD FROM THE GOP'S REJECTION OF A TOTALLY STATIST SCHEME. SUCH A SCHEME, HE SAID, WOULD PLACE GLOBAL INCOME IN THE HANDS OF THE BUREAUCRACY AND WOULD DEPRIVE PRODUCERS OF THE FRUITS OF THEIR LABOR. IT WOULD REDUCE DEMAND DRASTICALLY AND WOULD ENTAIL ENORMOUS SOCIAL COSTS. "THE MEASURES WHICH WE ARE APPLYING ARE EXPLAINED BY AN ECONOMY WHICH IS STILL CAPITALISTIC AND DEPENDENT, AND OBTAINS NECESSARY FINANCIAL RESOURCES IN TRADITIONAL MARKETS," FERNANDEZ MALDONADO SAID.

3. THE PRIME MINISTER WENT ON TO ATTACK THE POLITICAL RIGHT, STATING THAT IT LACKED THE MORAL AUTHORITY TO CRITICIZE BECAUSE ITS PROGRAMS HAD PRODUCED UNDERDEVELOPMENT IN THE PAST AND WOULD PRODUCE ECONOMIC CHAOS AT PRESENT. HE ALSO ATTACKED THE ULTRA-LEFTISTS, STATING THAT THEY HAD NO REALISTIC OR COHERENT PROGRAM OTHER THAN A DOGMATIC AND TOTALITARIAN ONE. HE CONCLUDED BY STATING "WE ARE ALMOST ROUNDING THE CORNER AND ARE ALMOST AT THE DOOR OF REALIZING THE REWARDS THAT WILL INITIATE OUR LEGITIMATE AND IRREVERSIBLE ECONOMIC TAKE-OFF."

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4. THE PRESENTATION OF MINISTER BARUA RELIED HEAVILY ON GRAPHS WHICH INDICATED THE GROWING DEFICITS IN THE CURRENT ACCOUNT OF PERU'S BALANCE OF PAYMENTS, THE DEFICIT IN HER TRUE ACCOUNT, AND THE GROWING GAP BETWEEN GROSS DOMESTIC INVESTMENT AND GROSS NATIONAL SAVING. HE STATED THE DEVALUATION FROM 45 SOLES TO 65 SOLES TO THE U.S. DOLLAR WAS NECESSARY TO REWARD EXPORTERS. HE ASSERTED

THAT THE TRADE DEFICIT WOULD BE ELIMINATED IN 1977 DUE TO A \$200 MILLION SAVING IN PETROLEUM IMPORTS AND A \$200 MILLION INCREASE IN COPPER EXPORTS.

5. BARUA ALSO NOTED THAT THE GAP BETWEEN THE REVENUES AND EXPENDITURES OF THE CENTRAL GOVERNMENT HAD GROWN ENORMOUSLY IN 1975. REDUCTION OF THIS GAP WAS NECESSARY BECAUSE GOING BEYOND THE LIMITS OF THE MONETARY PROGRAM WOULD PRODUCE UNCONTROLLED INFLATION. FOR THIS REASON IT WAS NECESSARY TO OBTAIN NEW PERMANENT FISCAL REVENUES AND TO CUT EXPENDITURES DRASTICALLY. HE NOTED THAT THE PUBLIC SECTOR'S FINANCIAL GAP HAD GROWN ENORMOUSLY SINCE 1973 AND CUTS IN INVESTMENT PROGRAMS OF PUBLIC ENTERPRISES WERE ALSO NECESSARY. IN DEFENSE OF THE DEVALUATION, HE NOTED RATES OF DEVALUATION IN OTHER LATIN AMERICAN COUNTRIES FROM 1968 THROUGH 1975: ARGENTINA - 643 PERCENT; BRAZIL - 111 PERCENT; CHILE - OVER 2000 PERCENT; AND COLOMBIA - 68 PERCENT. HE STATED THAT THE 15 PERCENT TAX ON THE FOB VALUE OF TRADITIONAL EXPORT PRODUCTS WAS NECESSARY TO HELP CLOSE THE FISCAL GAP, AND THAT THE INCREASE IN THE PRICE OF GASOLINE WAS MAINLY FOR THE SAME PURPOSE. IN REGARD TO THEIR FISCAL EFFECTS, HE NOTED THAT THESE TWO MEASURES WOULD YIELD 22.5 BILLION SOLES (\$346 MILLION) IN REVENUES TO THE CENTRAL GOVERNMENT. IN ADDITION, THE MEASURES WHICH CUT INVESTMENT PROGRAMS OF THE CENTRAL GOVERNMENT AND PUBLIC ENTERPRISES (AS WELL AS THE LIMITS ON CONTRACTING PERSONNEL AND OTHER CURRENT COSTS) WOULD SAVE 14.8 BILLION SOLES (\$228 MILLION) FOR A TOTAL REDUCTION IN THE FISCAL GAP AMOUNTING TO 37.3 BILLION SOLES (\$574 MILLION). HE STATED THAT THE ECONOMY-WIDE INCREASES IN WAGES WERE TO COMPENSATE FOR THE INCREASE IN THE COST OF LIVING. FURTHERMORE, THE SYSTEM OF PRICE CONTROLS WILL BE MAIN-LIMITED OFFICIAL USE

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TAINED, PARTICULARLY ON THE BASIC FOODSTUFFS.

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6. COMMENTS: (A) THE PRESENTATIONS OF THE PRIME MINISTER AND MINISTER OF ECONOMY AND FINANCE WERE MADE IN THE PRESENCE OF ALL OTHER MINISTERS AND LASTED ABOUT ONE HOUR. NO PRESS CONFERENCE FOLLOWED PRESENTATION AS WAS DONE IN THE SEPTEMBER 1975 AND JANUARY 1976 TV APPEARANCES OF MINISTER BARUA; (B) THE LECTURE GIVEN BY MINISTER BARUA WAS PERHAPS NECESSARILY INCOMPLETE IN TERMS OF ECONOMIC EXPLANATION, CERTAIN KEY POINTS WERE OMITTED, E.G., EXPECTED RATE OF INFLATION AS RELATED TO SLIDING SCALE OF WAGE INCREASES, AND GOP'S INTENDED POLICY ON SPECULATION AND PRICE INCREASES; (C) DEVALUATION, PARTICULARLY OF THIS MAGNITUDE, WAS NOT PASSED OFF AS A MINOR ADJUSTMENT WHICH WOULD HAVE NO IMPACT ON PRICES (AS WAS DONE LAST SEPTEMBER); (D) MINISTER BARUA UNDOUBTEDLY CONFUSED MOST OF HIS LIMITED OFFICIAL USE

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NATIONWIDE AUDIENCE WITH GRAPHICAL PRESENTATIONS OF GAPS (THE TRADE GAP, THE SAVING-INVESTMENT GAP, AND THE FISCAL GAP); IN FACT THE FISCAL GAP HAS SECULAR ECONOMIC SIGNIFICANCE BECAUSE IT INDICATES THAT THE REVOLUTIONARY GOVERNMENT HAS NOT IN FACT BROUGHT ITSELF TO MAKE THE MIDDLE AND UPPER INCOME GROUPS PAY THE PRICE OF A STATIST ECONOMY NOR HAS IT BROUGHT ITSELF TO MAKE THE LOWER INCOME GROUPS PAY THAT PRICE; (E) THERE WERE ONLY A COUPLE

OF THE MOST FLEETING REFERENCES TO THE NEED TO DEVALUE
TO MAINTAIN PERU'S EXTERNAL CREDITWORTHINESS; (F) MINISTER
BARUA PROBABLY OVERSTATED THE EXTENT OF THE NEW PROGRAMS'S

FISCAL RELIEF BY A WIDE MARGIN; (G) TURNING FROM THE
RECENT PRESENTATIONS TO THE NEW MEASURES THEMSELVES,
WE OFFER THE FOLLOWING OBSERVATIONS: (1) PERU'S NEW
ECONOMIC PACKAGE WOULD SEEM TO GO A LONG WAY TOWARD
MEETING THE COUNTRY'S IMMEDIATE ECONOMIC CRISIS, THOUGH
OTHER MEASURES, PARTICULARLY IN THE AREA OF INCENTIVES
FOR THE REFORMED PRIVATE SECTOR, ARE STILL LACKING;
AND (2) THE NEW MEASURES, WHICH AS REPORTED IN LIMA 6076
AND OTHER SEPTELS HAVE BEEN THE PROXIMATE CAUSE OF
CONSIDERABLE UNREST HERE, TOOK A GREAT DEAL OF POLITICAL
COURAGE TO ANNOUNCE.
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